SWISS CONTRACT LAW

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Selling by mistake: good faith as an impediment to avoiding the contract

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A Seller who fails to clarify a point of essence and mention it to the Buyer(s) prior to concluding a contract cannot rely on its mistake in order to avoid the contract or to refuse its performance.

Judgment of the Federal Supreme Court of 19 April 2022
Case Reference : 4A_29/2022

Facts

An individual (the **Seller**) entered into a sale agreement with two buyers (the **Buyers**) concerning the sale of several plots of land (including a house, barn and pastureland).

The notarized agreement was executed in October 2019, but provided for a deferred transfer of title, which was meant to take place in March 2020.

In a text message dated February 2020, the Seller unexpectedly informed the Buyers that she wished to "cancel" the sale. In a follow-up letter from her lawyer, the Seller contended that she was the victim of a "fundamental mistake" when concluding the sale and therefore did not consider the contract to be valid and binding.

The Buyers sued for transfer of title, which was awarded by the first-instance court. The judgment was later upheld on appeal by both the Zurich cantonal court and the Federal Supreme Court.

Throughout the proceedings, the Seller argued that due to her physical disability, she had previously intended to convert her barn into a residential building with a lift but was unable to do so due to the agricultural zoning rules in place. In 2016, an employee from the relevant authority informed her that she would be unable to secure a land conversion permit due to ever-more stringent regulations. Yet, in January 2020, shortly after the agreement had been signed, the Seller learned that the local building regulations would soon be reformed, allowing for land conversion in her area. The Seller argued that had she known this at the time of concluding the sale, she would not have entered into the agreement with the Buyers.

Issue

The Federal Supreme Court had to determine whether the Seller could, **in good faith**, allege a fundamental mistake within the meaning of Art. 24 para. 1 (4) of the Swiss Code of Obligations (SCO) in order to refuse to transfer title to the Buyers.

Decision

First, the Federal Supreme Court recalled that a contract is not binding for the party who was labouring under a fundamental mistake at the time of concluding the contract (Art. 23 SCO).

A mistake is deemed fundamental namely when a party is mistaken about certain facts that it considered in good faith to be a necessary basis for the contract (Art. 24 para. 1 (4) SCO). In addition to the mistaken party relying *subjectively* on these facts as an indispensable prerequisite for concluding the contract, these facts must also appear *objectively* necessary to the parties' agreement (i.e. from the standpoint of fair business dealings). The circumstances at the time of the conclusion of the contract are key.

Second, the Federal Supreme Court recalled that a fundamental mistake may be **the result of fault or negligence** on the part of the mistaken party. Art. 26 para. 1 SCO provides that a mistaken party who invokes its mistake to avoid a contract and whose mistake is attributed to its own fault or negligence, is liable for the damage resulting from the nullity of the contract, unless the other party knew or should have known of the mistake. Thus, while the negligent party may

have to pay damages to the other party under Art. 26 SCO, its negligence would not, as such, prevent the mistaken party from relying on its mistake to avoid the contract or to refuse its performance.

This must be distinguished from the case where a fundamental mistake is relied upon **in breach of good faith.** Art. 25 para. 1 SCO provides that a person may not invoke a mistake in a manner contrary to good faith. In this respect, the lack of good faith would impede the mistaken party from invoking its mistake. Thus, for example, if a party fails to raise a fact or a question it considers important when concluding the contract, the other party may legitimately conclude that its contracting partner did not consider it a necessary basis for the contract. In this scenario, the mistaken party would be barred from relying on its mistake, since an attempt to do so would be contrary to good faith.

In the case at hand, the cantonal court considered the Seller's mistake fundamental within the meaning of Art. 24 SCO. Despite this, it found that the Seller had invoked its mistake in breach of good faith.

While the Federal Supreme Court saw no reason to overturn these findings, it did add that the Seller's mistake was due to its own **negligence**. In fact, the last steps undertaken by the Seller to clarify the zoning rules dated back three years prior to the conclusion of the contract. As a "*fair, honest and conscientious contracting party*", she should have sought updated information before the sale, especially since legal norms are known to evolve. All in all, the Federal Supreme Court found that the Seller's failure to seek up-to-date information, which would be fundamental to her, was negligent within the meaning of Art. 26 SCO.

Beyond this finding of negligence on the Seller's part, the Federal Supreme Court ultimately confirmed that the Seller's attempt to *rely* on its negligent conduct was **contrary to good faith** within the meaning of Art. 25 SCO. In fact:

- the Seller failed to raise the issue of land zoning during the negotiations with the Buyers; in particular, she did not mention that the lack of prospects for land conversion was the underlying reason for the sale;
- the Seller's conduct did not otherwise demonstrate, in any recognizable way, that her decision to sell was based on her mistaken belief regarding the prospects of land conversion; and
- therefore, the Buyers could not have recognized the importance of this fact to the Seller. Rather, the Buyers could, in good faith, assume that the Seller had carried out the clarifications that were essential to her – especially since this was not an everyday transaction and the sale was not executed under strict time constraints.

Given the above facts, the Federal Supreme Court considered that the Buyers' **legitimate expectations** should be protected. It thus upheld the decision of the cantonal court to **deny** the Seller the possibility to refuse performance of the contract on the basis of a fundamental mistake.

Key takeaway

This case illustrates the distinction between ***negligence*** (which relates to the *cause* of a mistake) and the ***breach of good faith*** (which relates primarily to the *manner* in which said mistake is invoked).

As a general rule, negligence is not an obstacle to invoking a fundamental mistake. Thus, a party who operates under a mistaken belief due to its own fault or negligence is still entitled to avoid the contract or to refuse its performance, but may be found liable to pay damages to the other party under Art. 26 SCO.

However, negligent conduct can become problematic if relying on the resulting mistake can be perceived as a breach of good faith. Notably, a party cannot claim to be the victim of a fundamental mistake when it failed to undertake any necessary clarifications prior to concluding a contract. In this scenario, and by application of Art. 25 para. 1 SCO, the mistaken party would be unable to avoid the contract or to refuse its performance on these grounds.

Comments

This decision confirms previous case-law on the notion of **good faith** in relation to fundamental mistakes. Indeed, the Federal Supreme Court had previously found that if a party negligently fails (or does not bother) to clarify a certain question when concluding a contract, even though it may be an obvious matter of fact, the other party may reasonably conclude that this question is not a "necessary basis for the contract". Thus, negligent conduct may – in certain circumstances – entitle the other party to consider in good faith that the point in question is not fundamental to the deal (see case reference ATF 117 II 218, para. 4b).

While the Federal Supreme Court chose to deny the Seller's defence in application of Art. 25 SCO in this case, it is

interesting to note that the principle of good faith is also embedded in Art. 24 para. 1 (4) SCO itself (which relates to the very definition of fundamental mistake). Indeed, for a mistake to be deemed fundamental under Art. 24 para. 1 (4) SCO, it must be recognized or recognizable as such to the contracting party, as per the rules of good faith and fair business dealings. In this sense, the failure of a party to clarify a question prior to a transaction and to signal its importance to the other party may be regarded as relevant under both legal provisions.

Other sources presenting the case

Chernaya Viktoriya / Galli Dario / Vischer Markus, *Fahrlässiger Irrtum und Verstoss gegen Treu und Glauben*, in: dRSK, published on October 2022, available at: https://www.walderwyss.com/user_assets/publications/Fahrlassiger-Irrtum-und-Verstoss-gegen-Treu-und-Glauben.pdf

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